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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF CHAPARRAL CITY WATER COMPANY, INC., AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE CURRENT FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR INCREASES IN ITS RATES AND CHARGES FOR UTILITY SERVICE BASED THEREON.	DOCKET NO. W-02113A-04-0616 On remand from the Arizona Court of Appeals, No. 1 CA-CC 05-0002 **NOTICE OF FILING TESTIMONY SUMMARIES**

Pursuant to the Procedural Order dated June 25, 2007, Chaparral City Water Company ("Company"), an Arizona corporation, hereby submits this Notice of Filing Testimony Summaries in the above-referenced matter. The Company expects to call the following as witnesses on Monday, January 28, 2008 and attach their testimony summaries herewith.

1. Ernest A. Gisler,
2. Harold Walker, III, and
3. Thomas M. Zepp.

The testimony summary for the Company's final witness, Thomas J. Bourassa, is not included in this filing. It will be filed on Friday, January 25, 2008, as he is not expected to testify until Tuesday, January 29, 2008.

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Arizona Corporation Commission
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DATED this 24th day of January, 2008.

FENNEMORE CRAIG, P.C.

By [signature]
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ORIGINAL and 13 copies of the foregoing delivered for filing this 24th day of January, 2008, to:

Docket Control
Arizona Corporation Commission
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Phoenix, AZ 85007

COPY hand-delivered this 24th day of January, 2008 to:

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CHAPARRAL CITY WATER COMPANY, INC.

W-02113A-04-0616

On remand from the Arizona Court of Appeals, No. 1 CA-CC 05-0002

Summary of Pre-filed Testimony of Ernest A. Gisler

Ernest A. Gisler is the Planning Manager for Golden State Water Company and Chaparral City Water Company. Golden State and Chaparral City Water are subsidiaries of American States Water Company. Mr. Gisler is also a Registered Civil Engineer in the States of Arizona and California, a licensed Grade 4 Water Treatment Operator and Grade 2 Distribution Operator in State of Arizona, and a licensed T4 Water Treatment Plant Operator and D2 Distribution Operator in State of California.

Mr. Gisler filed rebuttal testimony in this case. Mr. Gisler's testimony is offered in direct response to RUCO witness Ben Johnson's testimony about the cost of reconstructing Chaparral City's utility plant, including his assertion that new technologies would reduce the cost of water infrastructure constructed today. Mr. Gisler's testimony reflects that Dr. Johnson's basic premise, that technology has reduced the cost of infrastructure, was flawed. According to Mr. Gisler's testimony, in the water industry, the technology associated with constructing water infrastructure is based on the same principles and technologies that were developed after World War II. Thus, the major cost contributors for pipeline installations are the same as they were in the 1960's, such as trenching costs, pipe costs, and the cost of bedding and backfill materials. In fact, according to Mr. Gisler, construction costs have increased due to more stringent design, construction and service standards and regulatory requirements.

In summary, contrary to Dr. Johnson's statement that "anyone wanting to build a new system today would take advantage of new technologies," Mr. Gisler testifies that "the costs for building a water system today would exceed the costs associated with constructing the 1960's system."

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CHAPARRAL CITY WATER COMPANY, INC.

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On remand from the Arizona Court of Appeals, No. 1 CA-CC 05-0002

Summary of Pre-Filed Testimony of Harold Walker, III

Mr. Walker is employed by Gannett Fleming, Inc., as Manager, Financial Studies of the Valuation and Rate Division. Mr. Walker has filed rebuttal testimony in this case. His rebuttal testimony responds to the direct testimony of Dr. Ben Johnson, filed by the Residential Utility Consumer Office ("RUCO") and David C. Parcell, filed by the Utilities Division ("Staff") as they relate to the fair value rate base ("FVRB") of the Company. Mr. Walker did not file any rejoinder testimony.

Mr. Walker reviewed and provided comments on the RCN study that was conducted by Thomas J. Bourassa in the initial phase of the case. He concluded that the approach used by Mr. Bourassa resulted in a reasonable estimate of the RCN values for the Company's depreciable assets at the end of the test year, December 31, 2003. He also concluded that Mr. Bourassa's RCN value understates the total RCN value because it did not include current measures of the value of land, organization and franchises, and other intangible plant. He noted that the Commission's method of averaging the original cost less depreciation rate base ("OCRB") and reconstruction cost new less depreciation ("RCND") rate base is a very conservative approach.

Mr. Walker also explained the methods used to estimate the value of assets, which are, generally, an asset-based approach, an income approach, and a market approach. He explained the differences between the use of an original cost method, a trended original cost method, a reproduction cost method and a replacement cost method for valuing assets. He also discussed income and market based approaches that can be used, but notes that individual utility assets are especially suited for asset-based valuation approaches because the assets of a utility represent "specialty property," i.e., property that is unique, designed for a specific purpose and has a limited market.

Mr. Walker then addressed Dr. Johnson's assertion that the replacement cost of the Company's water system is lower than its reconstruction cost, and explained why Dr. Johnson's assertion is erroneous. He also addressed Dr. Johnson's contention that the application of the same percentage rate of return to a fair value rate base as would be applied to an original cost rate base would overcompensate Arizona investors. There are different approaches used by various regulatory commissions, and the 19 percent difference between the Company's OCRB and FVRB is well within the range of quantifiable differences in valuation resulting from the different methodologies that are used. Mr. Walker also compared the total market value of publicly traded water utilities to the Company's FVRB, again concluding that the FVRB used in this case is very conservative and investors will not be overcompensated if the rate of return is applied to the FVRB rather than the OCRB.

Mr. Walker also discussed the relationship between a utility's earnings and its rate base, explaining that under financial theory, and from an economic valuation perspective, the value of an asset is equal to the present discounted value of future cash flow that ownership of the asset will provide, and not what was invested in the asset in the past. If the revenue stream (i.e., allowed earnings) is based on OCRB rather than FVRB, the value of the Company's property would be driven downward to its OCRB. In other words, if OCRB is used to determine allowed earnings, the value of the Company's property would never exceed OCRB, regardless of any asset-based estimates of current value.

Mr. Walker provided comments on Dr. Johnson's proposed 2 percent inflation adjustment, which results in an authorized cost of common equity of only 5.96% -- more than 330 basis points lower than the 9.3% return adopted by the Commission. He also briefly commented on Staff's "zero cost" capital proposal and explained that Staff's proposal would fail to produce the level of earnings required to support the determined FVRB. The effect of this recommendation is to drive down the value of the Company's assets.

Mr. Walker concluded by addressing Mr. Parcell's assertion that a "zero cost" should be applied to the difference between the Company's FVRB and its OCRB because investors have not financed the difference. Mr. Walker explained that the difference between the FVRB and the OCRB belongs to the Company's equity investors, who have risked their capital by investing in assets that have increased in value. Consequently, the investors are entitled to a fair return on those assets' current value.

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CHAPARRAL CITY WATER COMPANY, INC.

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On remand from the Arizona Court of Appeals, No. 1 CA-CC 05-0002

Summary of Pre-Filed Testimony of Dr. Thomas M. Zepp

Dr. Zepp testifies on the appropriate cost of capital for Chaparral City Water Company in this remand from the Court of Appeals. He is an economist and Vice President of Utility Resources, Inc., a consulting firm established in 1985. Dr. Zepp received his Ph.D. in Economics at the University of Florida, where he also taught economics and business courses at the graduate and undergraduate level. Before establishing Utility Resources, Dr. Zepp was a consultant at Zinder Companies from 1982 until 1985, and was a senior economist on the staff of the Oregon Public Utility Commissioner from 1976 to 1982. Dr. Zepp has testified before two Canadian regulatory bodies, 4 federal agencies and in 22 states on cost of equity, values of utility properties, economic costs of utility services, appropriate rate designs and other economic issues.

In the hearings before the remand, Dr. Zepp prepared direct, rebuttal and rejoinder testimony on behalf of Chaparral City on the cost of capital. His recommended returns on equity were based on the discounted cash flow ("DCF") model and the Risk Premium method used by the Staff of the California Public Utility Commission ("PUC") and were entirely independent of either the type or amount of the Company's rate base.

In this remand, Dr. Zepp prepared rebuttal and rejoinder testimony that address issues related to the cost of capital. Dr. Zepp notes that all of the parties' witnesses recognize that Arizona differs from other jurisdictions because of the requirement embodied in the Arizona Constitution that the fair value of the utility's plant and property be found and used in setting rates. The Arizona Constitution provides that "the corporation commission shall, to aid it in the proper discharge of its duties, ascertain the fair value of the property within the State of every public service corporation doing business therein." Arizona Constitution, Art. XV, § 14.

Based on the Arizona Constitution and court decisions, Dr. Zepp explains, investors should expect to earn a return on the "value of the property used at the time it is being used," as the U.S. Supreme Court said in the *Bluefield Waterworks* case, and "the value of properties at the time of inquiry," as the Arizona Supreme Court said in *Simms v. Round Valley Light & Power*. That dollar return will be either higher or lower – and would only be the same return by accident – than the return earned on OCRB, and thus there is no windfall gain.

Dr. Zepp explains that the determination of both the return on equity and the overall rate of return on FVRB is <u>independent</u> of the determination of an original cost rate base ("OCRB") and determination of the value of the fair value rate base ("FVRB"). Dr. Zepp also explains that the arguments of Mr. Parcell (on behalf of Staff) and Dr. Johnson (on behalf of RUCO) that the cost of equity estimates used in this case are tied to the Company's OCRB have no foundation in fact or theory. Their claims also ignore the fact that unregulated firms, which could care less about the original cost of their assets, rely on market-determined costs of equity.

Dr. Zepp explains that Mr. Parcell and Dr. Johnson have offered alternative methods that do not address the concerns raised by the Arizona Court of Appeals in its decision. Mr. Parcell's use of a "zero cost" capital component is merely another superfluous mathematical exercise, akin to the prudent investment theory, being used to keep rates in the range they would be if based on original cost. Thus, Mr. Parcell merely offers a transparent twist to the same method the court found unlawful and provides no assistance to the ACC in addressing the issue raised in this remand proceeding.

In response to RUCO's testimony, Dr. Zepp explains that RUCO's inflation argument is not only based on erroneous facts and assumption about recovery in the future, but also dramatically overstates the impact of inflation on the fair value rate base determined by the Commission. Dr. Johnson offers a method inconsistent with not only the Arizona Constitution but also with well known U.S. Supreme Court decisions, which require investors be given a reasonable opportunity to earn a fair rate of return. Contrary to Dr. Johnson's contentions, the method he proposes not only denies investors a reasonable opportunity to earn a fair rate of return today, but the cumulative burden of that lost return will increase over time, even if the fair value rate base increases at the rate he speculates will occur.

Dr. Zepp recommends that the Commission determine operating income by multiplying the FVRB by the rate of return previously determined by the Commission in this case, which is 7.6%. While he does not agree that a return on equity as low as 9.3%, which is was used to calculate the 7.6% return, is reasonable for Chaparral City, the Arizona Court of Appeals concluded that this return on equity was neither unlawful nor unreasonable. Consequently, the Company is not challenging the return on equity and resulting return on rate base in this remand proceeding.

Dr. Zepp's recommendation recognizes that the framers of the Arizona Constitution as well as Arizona voters in three different elections have determined it is appropriate for investors to gain or lose if the value of the assets used to provide service change in value from year to year. Thus, the appropriate rate base to use when setting rates is the FVRB, i.e., the value of Chaparral City's assets at the time of inquiry. His recommendation also recognizes that the U.S. Supreme Court requires a fair rate of return to be applied to the assets being used to provide service to the public. In Arizona, those assets are valued at the time of inquiry, not when they were originally purchased or constructed.

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